



## **Role of Offsets Under AB 32**

### **Comments by Environmental Entrepreneurs (E2)**

E2 is pleased to provide comments on the “Key Questions for Discussion” presented at the stakeholder workshop on offsets on April 4<sup>th</sup>, 2008.

#### **Should California have an offsets program for compliance purposes?**

A limited use of offsets for compliance will provide flexibility for capped entities while also ensuring that capped sectors do not outsource their reductions. E2 believes an offset program for compliance needs to be limited to a small percentage of required reductions to insure that capped sectors focus their investments to reducing their direct emissions.

In addition to the goal of meeting the 2020 targets in an economically beneficial manner, California needs to be on track to meet the 2050 targets of near zero GHG emissions (from today’s 14 tons CO<sub>2</sub>E/person to 1.5 tons CO<sub>2</sub>E/person. This means that every sector needs to focus on innovations early. Since not all sectors are in a position to achieve reductions at the same pace and at the same cost, it is appropriate that the offset limit be determined on a sector-by-sector basis.

We support the suggestion from The Nature Conservancy to differentiate emission reduction by using the terms “Compliance Credits” and “Offsets”. As recommended in Chapter Two of the ETAAC report (The California Carbon Trust Recommendation), the state of California could use proceeds from an allowance auction to become an active participant in the voluntary Offset market. By being a ready buyer of voluntary Offsets, the state would encourage reductions outside the capped sectors, encourage early action, encourage innovation and provide a price floor. Voluntary Offsets in disadvantaged communities could be offered a premium price. This would enable the state to achieve both the GHG reductions and the co-benefits intended by AB 32.

#### **What should the project approval and quantification process be for approving projects?**

Only projects based on CCAR protocols should be eligible for Compliance Credits. E2 assumes that a category of projects and protocols will be pre-defined. One of the many requirements for Compliance Credits is an “Additionality” test. An aspect of Additionality is that the project is not common business practice – i.e. the project wouldn’t have happened without the particular financial incentive from the Compliance Credit. Initially this may be due to the project risk being too large or the economic benefit too small to be common practice. Selling a Compliance Credit increases the economic benefit to overcome the business risk. Over time, technical improvement may make a project type common business practice. E2 recommends that CARB perform an annual

review of project types to confirm they still meet the Additionality test and if they are at a point where they are approaching common business practice, CARB should provide a one-year notice that the project type will no longer be eligible for Compliance Credit. This one-year notice will encourage the existing project pipeline to be completed and in fact, may cause a short-term acceleration of projects.

California should require Compliance Credits to be insured in order to create the highest quality credits. California should insist on real reductions and not monetary penalties. A private insurance market that might result from this requirement will cause additional reductions and the price of insurance will provide market validation of the integrity of the Compliance Credit provider and project type.

### **Should there be quantitative limits? How should they be determined?**

For the reasons we described above, there should be limits on Compliance Credits. This will insure that reductions and innovation occur in the capped sectors. The limits should be based on known ways of achieving reductions within a sector and should vary by sector.

### **Should California establish geographic limits?**

Compliance Credits should be limited based on California's ability to enforce compliance. Given the volume of work CARB has to implement AB 32, it would seem reasonable to defer considering international credits for the time being. It is consistent with California's work with WCI that the focus for Compliance Credits is in California and the WCI states.

California's active participation in voluntary Offsets should be mostly focused, but not exclusively focused, in California. This is consistent with the AB 32 language that encourages local benefits for California communities and economic benefits to the state.

In summary, E2 supports the limited use of offsets for compliance. Compliance credits should be differentiated from the voluntary Offset market. The Compliance Credit provides flexibility for regulated entities. The Offset market allows all Californians to participate in reductions. This active voluntary market will encourage innovations that would not otherwise happen in the same timeframe. The voluntary Offset market would also create a mechanism for California to provide benefits to disadvantaged communities through projects that don't meet the strict requirements for a Compliance Credit but provide local benefits.

Thank you,

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